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Perspectives

Repo rate: Will RBI heed to govt call?

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Macroeconomic stability (growth with price stability) are the shared goals of government and central bank. Both have been assigned domains of operations: fiscal policy and monetary policy. However, every fiscal policy measure affects aggregate demand. Since the governments are elected, their return to power depends on their performance. Fiscal expenditures are funded by tax revenue, some time by y borrowing from central bank. , which is inflationary. Central banks should have the courage to say " No to Fiscal Abuse" ! Statutory independence for central bank is an important requirement for a healthy, political and economic system.

Last month, the differences between government and Reserve Bank of India(RBI) on the interest regime (REPO rate of 6.50%) adopted for fighting inflation since February 2023 and continued to date, were aired publicly. Speeches by Commerce and Finance Ministers and Chief Economic Adviser (CEA) raised questions on the intent -are these signals to RBI's Monetary Policy Committee (MPC), before its scheduled bimonthly meeting on December 4-6 for setting a new

REPO? Unfortunately, they came into the open, as RBI Governor Shaktikanta Das's tenure was to end just four days after MPC meeting.

On November 14, Commerce Minister Piyush Goyal said on November 14 RBI must cut interest rates, ignoring food inflation. He claimed considering food inflation to decide on cutting interest rate is a flawed approach and he noted, interest rate at 6.50% was hurting consumption and investment. The GDP growth rate in the July-September quarter (Q2 FY25) was only 5.4%, compared to 8.1% in the corresponding Q2 FY2. It is also a drop from 6.7% in Q1 FY25. Certainly, government's concerns are understandable.

On November 18, Finance Minister, Nirmala Sitharaman said, at State Bank of India's 11th Annual Banking and Economics Conclave in Mumbai that the lending rates, are causing "stress to borrowers,". She wanted the lending rates "should be made affordable". Her comments were reported in the media as indicative of " intensifying" differences between government and RBI.

A day later, Chief Economic Advisor (CEA) Anantha Nageshwaran spoke to the SBI Conclave: "We know that CPI is being very much influenced by a few commodities. If you take out tomato, onion, potato, gold and silver, the headline CPI rate is 4.2 per cent… the items that constitute a 3.4 per cent weight, together account for more than one-third of the 6.2 per cent inflation rate we have seen for October."

The MPC keeps in mind the inflation target rate of 4%. which was jointly agreed to by government and RBI in August 2016, which is valid till March 31, 2026. It is calculated as the annual percentage change in the monthly Consumer price index based on items of final consumption at retail level. As November inflation data will not be available, until mid-December, the Repo has to be decided based October inflation data (6.21%). Food inflation in October was at its highest, 10.90%

Shifting goal posts

Food inflation holds particular significance in India due to its large low-income population. The country more sensitive to price changes in food items. Food and beverages constitute 46 % of total consumption goods. The CEA’s selective approach to inflation calculation is based on expediency. One cannot take out ‘‘inconvenient items” and add “convenient” items. It amounts to changing the goal posts in the midst of a football game.

It was left to a bureaucrat to put the lid on an embarrassing debate. Very next day, Ajay Seth, Secretary of Department of Economic Affairs told at a Convention in New Delhi that “despite sectoral slowdowns, there were no significant risks to the 2024-25 growth projection of 6.5%-7%”.. He acknowledged the role of weather-related factors in food inflation and pointed out that monetary policy falls under the RBI’s domain.

Finance Ministry’s latest October Monthly Economic Review (October 2024) is optimistic on food situation thanks to improved and favourable monsoon conditions, increased minimum support prices and adequate supply of inputs. However, the global economic landscape is changing with the return of Donald Trump, as president of the United States. His protectionist policies, and plans forced deportation of illegal immigrants could lead to a rise in US inflation through tariffs, and rise in labour shortage Critical imports from US would become more expensive and hurt India’s exports. The RBI’s role is crucial in maintaining both domestic and external stability of the rupee . By keeping the repo rate unchanged, the RBI would continue to assure financial markets of India's commitment to stability, which is vital for sustaining not only domestic but also overseas investor confidence. That would contribute to stemming the outflows of foreign portfolio investment, which resulted in decrease in foreign exchange reserves level and halt depreciation of rupee.

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